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No. 99-1574

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

LOCAL 1199J,

Petitioner,

v.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF UNITED HEALTH CARE SYSTEM, INC.

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN SUPPORT OF PETITIONER

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BRIEF IN SUPPORT OF PETITIONER

STATEMENT

United Health Care System, Inc., herein United, is a New Jersey not-for-profit corporation which provided hospital and health care services in Newark, Orange, East Orange and Irvington, New Jersey. United employed approximately 1,300 to 1,600 employees. JNESO is the certified collective bargaining representative for the approximately 461 registered nurses previously employed by United as Debtor and Debtor-in-Possession.

United was experiencing financial difficulties by early 1996, including a projected loss of $25 million and had abandoned any effort to obtain long-term conventional financing.

Rather, United, thereafter, exclusively pursued a merger or partnership with other health care institutions as a solution to its financial difficulties. As early as August 21, 1996, United's Board of Trustees recognized that the Hospital would not stand alone and needed a partner. The minutes of United's Board of Trustees dated September 25, 1996, indicate that, "the Committee came to the conclusion that United does need a partner to survive in this environment and that time is of the essence in coming to a conclusion as to who that partner will be."

By the fall of 1996, Debtor's financial position had become so extreme that it had ceased paying its premiums for employee health insurance to Blue Cross/Blue Shield in October and to U. S. Health Care in December. Further, commencing in November 1996, Debtor's officers converted, for its business purposes, the following deductions from the paychecks of the registered nurses:

1. Health insurance co-payments which has resulted in Blue Cross terminating the employees' health insurance on or about February 7, 1997;

2. Credit union loans which has resulted in the employees defaulting on home mortgage loans, automobile loans, etc.;

3. Credit union savings accounts;

4 401(k) pension funds;

5. Federal savings bonds;

6 Court ordered child support and alimony payments; and

7. Union dues.

On January 15, 1997, United failed to meet its payroll tax obligation.

In order to maintain its business operations while it searched for a merger partner or purchaser, United arranged interim financing with Daiwa Health Co.-2LLC, herein Daiwa. United was aware that the interim financing was not sufficient to sustain the hospital's operations on an on-going basis and that it was merely a temporary measure.

Throughout the fall and winter, United carried on discussions with various health care institutions seeking a merger or purchaser. From the vantage of maintaining the Hospital's operations on a long-term basis, the most promising discussions were with Primary Health Care, which proposed maintaining United's operations with a reduced work force of 900 employees, a loss of 400 to 600 jobs — sufficient to trigger the WARN Act's notice requirements. It is undisputed that United did not advise its employees of the potential for layoffs or closure of its Hospital. In this regard, United had concluded that notice to employees would have destroyed it's attempt to merge with another institution or successfully seek a third-party purchaser. Throughout this period, the registered nurses and the Hospital's other employees continued in their faithful service to Debtor's hospital, its patients and the community. Thus, the Debtor's employees worked to preserve the hospital's operations and value to a potential purchaser or merger partner, unaware of the financial exigencies, which would destroy that which they labored to build and nurture.

On February 18, 1997, United concluded an agreement with St. Barnabas Healthcare System, providing for a purchase of assets for $13 million. The agreement specifically required United to give notice under the WARN Act as a condition of the agreement. Thus, the agreement, at Section 7, *Representations and Warranties of Seller*, Subsection (C), *Closing; Continued Employment*, provided

> Seller shall give written notice to all of its employees respecting closing of United's facilities, and shall continue to employ its employees thereafter, as required by, and

> shall otherwise fully comply with, all provisions of applicable state and federal law (including, without limitation, the WARN Act).

The necessary funds to cover the cost of the wages and health benefits for said employees are specifically set forth at Section 6, *DIP Loan*, which states in relevant part:

> The DIP Credit facility shall be drawn upon by seller in such notice as the bankruptcy court may direct, and shall be used exclusively for the following purposes:
>
> (i) payroll and health benefits;

On February 19, 1997, United filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code, which was effective as of 12:01 a.m. Further, on February 19, 1997, United provided all employees with sixty (60) days' notice of the closure of United's operation and corresponding termination of employment ("Termination Notice"). The Termination Notice provided that employment would end on April 20, 1997, or within fourteen (14) days of that date. The Termination Notice was ostensibly provided under the WARN Act, which requires certain employers to give at least sixty (60) days' advance notice of a plant closing or mass layoff. JNESO, the union representing Debtor's registered nurses, was not provided the notice until February 27, 1997. Pursuant to Section 2102(a)(1) of the WARN Act, an employer cannot order a plant closing or mass layoff until the end of a sixty-day period after the employer serves written notice of such an order to the representative of the affected employees.

Following the filing of the bankruptcy petition, United's employees continued in their employment. For several days, registered nurses and other employees continued to provide direct patient care to patients at the hospital. (App. 2a). Thereafter, employees continued to provide cleanup, inventory and other services to preserve United's assets. (Id.)

On March 4, 1997, the Unsecured Creditor's Committee, herein the Committee filed an emergent application for an Order directing United to immediately terminate all its employees, except those necessary to protect the Debtor's property. The Committee argued, *inter alia*, that United, as Debtor-in-Possession, was not an employer for purposes of the WARN Act.

In an opinion and order filed on March 26, 1997 (App. A), the Honorable William F. Tuohey of the United States Bankruptcy Court for the District of New Jersey denied a motion filed by the Unsecured Creditors' Committee, herein referred to as "Committee," to (i) immediately terminate all employees of United Health Care System, Inc., herein the Debtor, except those necessary to protect property and (ii) to provide appropriate written notice of such termination. Specifically, Judge Tuohey held:

> (1) that the Debtor was subject to the Worker Adjustment and Retraining Notification Act (WARN Act), 29 U.S.C. § 2101, *et. seq.*;
>
> (2) that the statutory "faltering company" and "unforeseeable business circumstances" exceptions to the WARN Act did not apply to the Debtor; and
>
> (3) that the employees' back-pay claim under the WARN Act was entitled to a first priority as an administrative expense under Sections 503 and 507 of the Bankruptcy Code.

Following the Committee's timely appeal to the United States District Court for the District of New Jersey, the Honorable Joseph A. Greenaway denied the Committee's Appeal and affirmed the Opinion and Order of the Bankruptcy Court. Judge Greenaway also recognized that Debtor continued as an employer, subject to the WARN Act, while it continued to employ its 1,300 employees for 16 days after the Debtor's bankruptcy filing of February 19, 1997. In particular, the

District Court noted that, in its agreement to transfer its major asset to the St. Barnabas Healthcare Center, Debtor agreed to meet its WARN Act obligations out of the proceeds of the transfer.

Following the Committee's timely appeal to the United States Court of Appeals for the Third Circuit, the Third Circuit reversed the District Court and held that United, as Debtor-in-Possession, was not an employer engaged in a business operation within the meaning of the WARN Act. In so ruling, the Third Circuit undercut employees' protection from economic dislocation as guaranteed by the WARN Act and created a cynical path for businesses to evade their responsibilities to their employees.

On March 28, 2000, Petitioner Local 1199J filed a timely Petition for a Writ of Certiorari. The issue on appeal is whether the protections of the WARN can be simply evaded by filing a petition for Bankruptcy and, thereafter, proceeding to liquidate assets.

ARGUMENT

As noted by the Bankruptcy Court "there is no doubt that United's plant closing and massive layoff would, absent bankruptcy, trigger the notification requirements under WARN." (App. 7a). While the Committee argued that the Debtor did not succeed to United's obligation under the WARN Act because it was a "liquidating fiduciary," the Bankruptcy Court concluded that the Debtor-in-Possession, as fiduciary, succeeded to the WARN Act obligations of United since Debtor's 1,300 employees continued to work on a daily basis for sixteen days after the Chapter 11 petition was filed. *Id.* The District Court affirmed the Bankruptcy Court's conclusion noting that Debtor's 1,300 employees were requested to continue to report to work for 16 days and that Debtor's agreement with St. Barnabas Healthcare System stipulated

that Debtor would give notice to its employees pursuant to the WARN Act. The Circuit Court reversed, concluding that the Debtor was not an employer since it had surrendered its Certificate of Need and was not operating the Hospital on an ongoing business enterprise.

The public policy underlying the WARN Act is extraordinarily strong and compelling. 20 C.F.R. § 639.1(a) states that the purpose of the WARN Act is to provide:

> protection to workers, their families and communities by requiring employers to provide notification 60 calendar days in advance of plant closing and mass layoffs. Advance notice provides workers and their families some transition time to adjust to the prospective loss of employment, to seek and obtain alternative jobs and, if necessary, to enter skill training or retraining that will allow these workers to successfully compete in the job market.

The Act's applicability to the instant case is even more compelling than in the normal case of closing and mass layoffs. Commencing in November 1996 through the date of the bankruptcy petition, United's officers unilaterally and secretly diverted employee wages, which had been withheld from its employees' pay, to its own business purposes. Thus, the employees involuntarily contributed their medical benefits, life savings, mortgage payments, child support payments and union dues to Debtor's efforts to preserve its assets pending a sale or merger, even though such sale or merger would still have resulted in the mass layoff of employees. At the very time employees should have been conserving their resources for the devastating times ahead, Debtor was secretly draining their ability to cope with their impending unemployment. Debtor's mass layoff has not only left its employees jobless, but has destroyed their credit ratings and left them mired in debt.

The Third Circuit concluded that the Debtor is not a "business enterprise that employs ... 100 or more employees" under 29 U.S.C. § 2101(a) because it is a liquidating fiduciary. The Third Circuit did not rely on the Department of Labor's Final WARN Rule, 20 CFR § 639, in which the Department refused to address the status of fiduciaries in bankruptcy. Rather, the Third Circuit relied on the Department's supplementary information providing guidance with respect to the Final Rule. Thus, in refusing to change the Final Rule to address fiduciaries, the Department stated:

> Another commenter suggested that "fiduciaries" in bankruptcy proceedings should be excluded from the definition of employer. Since adequate protections for fiduciaries are available through the bankruptcy courts, the Department does not think it appropriate to change the regulations to address this situation. Further, DOL agrees that a fiduciary whose sole function in the bankruptcy process is to liquidate a failed business for the benefit of creditors does not succeed to the notice obligations of the former employer because the fiduciary is not operating a "business enterprise" in the normal commercial sense. In other situations, where the fiduciary may continue to operate the business for the benefit of creditors, the fiduciary would succeed to the WARN obligations of the employer precisely because the fiduciary continues the business in operation.

54 Fed. Reg. 16,045 (1989).

The Third Circuit's reliance on the Department of Labor's foregoing advice is misplaced and undercuts the employees' WARN Act protections. The Department's advice was provided for guidance only and was not to be interpreted as imposing any new or additional standards beyond those in the Final WARN Rule. 54 Fed. Reg. 16,042 (1989)(R7). Further, the Department, in the context of a discussion of the effects of collective bargaining agreements on WARN Act obligations,

advised that where the provisions of an agreement are consistent with and not inferior to WARN requirements, application of those provisions to further define or clarify WARN in terms of a specific context would satisfy WARN. 54 Fed. Reg. 16,044 (1989). The Third Circuit failed to recognize that, the agreement between Debtor and St. Barnabas clarified the Debtor's WARN Act obligations.

In the instant case, the sole remaining cash asset within the Debtor's estate at the time of the Committee's application was approximately $2 million, which represented the balance of the deposit from the sale of Debtor's "good will" to St. Barnabas. (App. 17a). This remaining cash asset was, thus, the product of the agreement negotiated between the Debtor and St. Barnabas and which was contingent on Debtor giving notice to and continuing to employ its employees. That agreement was the product of a lengthy series of bidding processes and negotiations between the debtor, various health care institutions and the Commissioner of Health. The agreement is consistent with the WARN Act and clearly clarifies and defines the application of the WARN Act in the instant context. St. Barnabas and the Commissioner of Health acted, in part, based on the agreement that the WARN Act requirement would apply to the Debtor. In the absence of that agreement, the Committee would not have proceeded in the instant matter because there would have been no available cash assets at that time.

Any reliance by the Third Circuit on *Teamsters, Local 572 v. Weslock Corp.*, 66 F.3d 241 (9th Cir. 1995) is misplaced. The Ninth Circuit's consideration of the definition of "a business enterprise" was limited to the context of a secured creditor which, through the provision of financing, monitored, and eventually brought to a halt, the production operation of the employer. Significantly, the secured creditor never employed any of the laid-off employees. Rather, the secured creditor ceased the employer's production operation at the

time it took possession of the employer's assets and subcontracted the security of those assets to a third party. Similarly, in *Adams v. Erwin Weller Co.*, 87 F.3d 269 (8th Cir. 1996), the Eighth Circuit concluded that a secured commercial lender was not an employer under the WARN Act merely because it cut off further capital to protect its investment.

In the instant case, the Debtor continued the employment relationship. For several days, the employees continued to provide direct patient care to Debtor's remaining patients. The employees' services were necessary to carry out the purchase agreement with St. Barnabas and to prevent malpractice and other claims by patients which would lead to the dissipation of Debtor's remaining assets. Thereafter, the employees continued to provide valuable services to the Debtor in reliance on Debtor's promise to comply with the WARN Act's sixty-day notice requirement.

It is obvious that the employees need their wages in order to survive. As noted by the Court in *In re Hanlin Group, Inc.*, 176 B.R. 329 (Bankr. D.N.J. 1995):

> WARN gives the employer a choice—it may provide 60 days' notice of closing or layoff to its employees, keeping the business open and incurring operating expenses during that period; or it may shut down its operations with little or no notice to its employees, saving operating expenses, but providing back pay to its employees, in compensation for the lack of notice, in accordance with a statutory formula. Thus, the purpose of the WARN is to provide a statutory form of severance pay.

In the circumstances of this case, the employees were not given a choice as the Debtor's finances deteriorated. Rather, their sole opportunity for a choice was when they were confronted with the opportunity to abandon Debtor's patients in the Hospital's waning hours. For two months, both the hospital administration and New Jersey state officials beseeched

JNESO representatives and its members, the registered nurses, not to abandon the United Hospital patients. They honored their nursing commitment to said patients, most of whom were children. Now the nurses ask that the commitment made in the Agreement between Debtor and Saint Barnabas be honored.

CONCLUSION

The petition for a writ of certiorari should be granted.

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DATED: April 17, 2000

APPENDIX

APPENDIX

[Filed Mar. 26, 1997]

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

Case No. 87-21785
Chapter 11
Hearings: March 7, 21, 1997

In Re: UNITED HEALTHCARE SYSTEM, INC.
Debtor-on-Possession

OPINION

TUOHEY, WILLIAM F.

PROCEDURAL HISTORY

United Healthcare System, Inc. ("United" or "debtor") filed a Chapter 11 bankruptcy petition on February 19, 1997. The debtor formally operated a full service hospital within the City of Newark, New Jersey as well as certain clinic facilities.

Simultaneously with the filing of the bankruptcy petition on February 19, 1997, the debtor sent all of its employees a notice advising that all employees would be terminated approximately sixty (60) days from the filing of the bankruptcy. (Letter to employees dated February 19, 1997 attached as Exh. B to Unsecured Creditior's Motion). On March 4, 1997, the Unsecured Creditor's Committee ("Committee"), represented by Riker, Danzig, Scherer, Hyland and Perretti, with Dennis O'Grady appearing, filed an Order Shortening Time with the Bankruptcy Court seeking to have the Court direct the debtor to immediately terminate all employees except

those necessary to protect the debtor's estate. The matter was heard before the Court on short notice on March 7, 1997 and said hearing was continued on Friday, March 21, 1997. At the conclusion of the hearing, the Court reserved decision. The issue presented by the application of the Unsecured Creditor's Committee goes to the allowance or disallowance of claims against the estate and is thus a "core" proceeding as defined by 28 U.S.C. § 157.

FINDINGS OF FACT

The debtor is a New Jersey not for profit corporation which provided hospital and healthcare services to Newark, Orange, East Orange, and Irvington, New Jersey. As of the filing date, the debtor employed approximately 1,300 employees. The debtor in its answering papers filed March 7, 1997 to the application of the Committee to terminate employees states:

> "On February 19, 1997, the debtor provided all employees with sixty days' notice of the closure of United's operations and corresponding termination of employment. The termination notice provided that employment would end on April 20, 1997 or within fourteen days of that date. The termination notice was provided under the WARN Act, 29 U.S.C. ¶ 2101-2109, which requires certain employers to give at least sixty days advance notice of a plant closing or mass layoff." (Debtor's objection to Committee Application, at p. 2).

After the bankruptcy petition was filed on February 19, 1997, debtor continued having all of its 1,300 employees report to work each day. Within 48 hours after the filing of the bankruptcy, all of the debtor's patients had been discharged either to home or transferred to other healthcare facilities. Nonetheless, debtor's 1,300 employees continued to work at the hospital on a daily basis after the Chapter 11 petition was filed. The employees were engaged in cleaning, the taking of inventory of debtor's supplies, and the readying of debtor's

assets for a liquidation sale. This procedure of having all employees report to work and to continue with the cleanup and securing of debtor's physical plant continued for a sixteen day period after the filing of the Chapter 11 petition. Ultimately, on March 6, 1997, debtor issues a furlough notice to all of its employees advising them that they were not to report to duty with the exception of a small contingent of approximately 100 employees who continued to work down to the present time securing debtor's plant and maintaining necessary equipment through maintenance. (Furlough Notice Exh. C-1 in evidence).

At the hearing held on March 7, 1997 on page 18, the Committee and the debtor stipulated that the projected payroll pursuant to the terms of the debtor's February 19, 1997 letter to its employees agreeing to pay the employees until April 20, 1997 created a $7.3 million payroll obligation. (TR. March 7, 1997, at p. 18, 1, 14 and following).

That number of $7.3 million included the projected payroll to be paid on March 13, 1997 which covered the pay period February 23 through March 8, 1997. The Court has taken into evidence as Exh. D-2 an analysis prepared by debtor setting forth its projected warn Act liability. The second page of Exh. D-2 notes the pay period that ended February 22, 1997 included wages earned pre- and post-bankruptcy. Thus, three days' wages for February 20, 21 and 22, 1997 post-filing are included in the payroll period that closed on February 22, 1997. The gross payroll for said three-day period after the filing is $639,665. Said pay period was actually paid to the employees by Court-approved checks that were submitted to the employees on Thursday, February 27, 1997. The Court notes the debtor pays its employees every two weeks and that the paychecks are issued on a Thursday. Thus, on February 27, 1997, the employees were paid their wages for the two-week period prior to Saturday, February 22, 1997. The next check after February 27, 1997 was issued to the employees on

Thursday, March 13, 1997. The March 13, 1997 check represented payment for the two-week pay period that terminated on Saturday, March 8, 1997. As has been noted, with the exception of100 employees, effective March 6, 1997 all employees were furloughed and told not to report to duty. Thus, approximately 1,200 of debtor's employees have not reported to work since the close of the pay period on Saturday, March 8, 1997 pursuant to the Furlough Notice. The one exception to this is the 100 employees that have been maintained for security and other purposes.

All sides agree that an employee who finds employment elsewhere during the sixty-day WARN Act windows relieves debtor of an obligation to pay that employee. In this regard, when analyzing Exh. D-2, p. 2 in connection with the March 8, payroll set forth in Column 2 of the Exhibit, debtor has reflected a credit of $538,174 representing employees formally with debtor who have found employment with St. Barnabus and in addition, debtor has taken a credit for $32,291 representing wages due for employees who have taken employment elsewhere other than at St. Barnabus. Thus, debtor did project a March 8, 1997 payroll of $1,688,348 (Exh. D-2).

With the consent of the parties at the hearing on March 7, 1997, debtor was authorized to pay the employees for the pay period for the two-week period to March 8. This payroll estimated by debtor to be $1,688,348 was pursuant to the stipulation of the parties paid to the employees on March 13, 1997. Having done that, the projected going-forward payroll asserted by debtor to be a WARN Act liability for the period of time after March 8, 1997 is $5,078,929 as set forth in Exh. D-2 at p. 2. Column 3. It is further noted that based on the checks issued on March 13, 1997 covering the pay period through March 8, 1997, debtor has thus paid seventeen (17) days of post-petition wages to the employees and forty-three (43) days' wages remain of the sixty-days' WARN Act.

As outlined above, pursuant to prior orders of the Bankruptcy Court on March 13, 1997, debtor paid its normal payroll to the 1,300 employees. The checks issued by debtor on Thursday, March 13, 1997 covered the pay period running through Saturday, March 8, 1997. The issue before the Court today is whether the approximately 1,200 employees who were furloughed on March 7, 1997 continue to receive a paycheck. The next effective paycheck is to be issued by the debtor on Thursday, March 27, 1997 which would cover the two-week period commencing on or about March 8, 1997.

DISCUSSION

In determining an answer to the question posed above, the Court must address the following issues: (i) whether the WARN Act is triggered in this case; (ii) assuming it is, whether the exceptions to WARN set forth in 29 U.S.C. § 2102(b) apply, and (iii) should the Court find in favor of the debtor with respect to the above, whether the "back pay" under WARN to which the furloughed employees are entitled, constitutes a first priority administrative expanse of the United States pursuant to § 503(b)(1)(A) and 507(a)(1) of the Bankruptcy Code.

Upon a detailed review of the relevant provisions of the WARN Act, 29 U.S.C. § 2102, the Bankruptcy Code, 11 U.S.C. § 503(b)(1)(A) and § 507(a)(1) and the caselaw cited by the parties and independently researched by the Court in this case, as applied to the record before it, this Court concludes as follows: (i) United is an employer subject to the provisions of the WARN Act, (ii) neither the "unforeseeable business circumstances" exception of 29 U.S.C. § 2102(b)(2)(A) nor the "faltering company" exception of 29 U.S.C. § 2102(b)(1) apply, and (iii) the employees' WARN Act claims constitute first priority administrative expenses for wages pursuant to § 503(b)(1)(A) and 507 § (a)(1) of the Bankruptcy Code as "the actual, necessary cost and expense of preserving the United States.

I. TRIGGERING OF THE WARN ACT

The Worker Adjustment and Retraining Notification Act ("WARN" or the "Act"), 29 U.S.C. § 2101 (West Supp. 1996), provides that employees with one hundred or more workers must give at least (60) days' advance notice to affected workers or their representatives of a plant closing or mass layoff. Specifically, an employer is subject to the WARN Act's advance Notification requirement if the business enterprise employs either one hundred or more employees, excluding part-time employees, or one hundred or more employees who, in the aggregate, work at least four thousand hours per week, excluding overtime. *See* 29 U.S.C. § 2102(a)(1)(west Supp. 1996). Section 2102(a) of the WARN Act provides in pertinent part:

> "An employer shall not order a plant closing or mass layoff until the end of a 60-day period after the employer serves written notice of such an order." 29 U.S.C. § 2102(a).

The employer will only be subject to the notice requirements if the company maintains the requisite one hundred employees sixty days prior to the closing or layoff. *Id.*

The WARN Act notification requirements are triggered only by a "plant Closing" or "mass layoff." A plant closing is defined as a "temporary or permanent shutdown of a single site of employment or one or more facilities or operating units at that site, that results in an "employment loss" for at least fifty full-time employees during a thirty-day period." *Id.* at § 2102(a)(2). The employer must render the Final decision to close the plant before employees can claim that the Act has been violated. *In re Parke Imperial Canton, Ltd.*, 1994 WL 842777 (Bankr.N.D. Ohio 1994).

A mass layoff is defined as a reduction-in-force other than by reason of a plant closing, which results as employment loss during any thirty-day period for either (i) at least 50 full-

time employees who comprise at least 33% of the active full-time employees at that site, or (ii) at least 500 full-time employees, regardless of how many employees work at that site. 29 U.S.C. § 2101(a)(3)(A) and (B)(1)(ii). *See also,* 20 C.F.R. § 639.3(c). For an employee to bring an action against an employer for violation the Act's notice requirementrs, the plant closing or mass layoff must result in the employee's (i) termination (other than for cause); (ii) voluntary departure or retirement; (iii) layoff exceeding six months, or (iv) reduction in hours of more than 50% during each month of any six-month period. *Id.* at § 2101(b)(1).

There are a limited number of cases interpreting the Act's application in a bankruptcy content. However, the Department of Labor's Comments on the Act's regulations make explicit reference to a company in bankruptcy suggesting:

> "[A] fiduciary whose sole function in the bankruptcy process is to liquidate a failed business for the benefit of creditors does not succeed to the notice obligations of the former employer because the fiduciary is not operating a 'business enterprise' in the normal commercial sense. *In other situations, where the fiduciary may continue to operate the business for the benefit of creditors, the fiduciary would succeed to the WARN obligations of the employers precisely because the fiduciary continues the business in operation."* 54 Fed. Reg. 16042 (1989) (emphasis added) *See also, In re Hanlin Group, Inc.*, 176 BR 329 (Bankr.D.N.J. 1995) and *Hotel Employees Restaurant Employees Int'l Union Local 54 v. Elstmore Shore Associates*, 724 F.Supp. 333 (D.N.J. 1989).

In this case, there is no doubt that United's plant closing and massive layoff of employees would, absent bankruptcy, trigger the notification requirements under WARN. In the Chapter 11 context, however, the debtor-in-possession ("DIP") as fiduciary succeeded to the WARN obligations of United under the second scenario outlined by the Department

of Labor Comment emphasized since debtor's 1,300 employees continued to work on a daily basis for sixteen days after the chapter 11 petition was filed. Thus, this Court concludes United, the debtor-in possession, is an employer subject to the provisions of WARN. *In re Hanlin, 176 B.R. at 332.*

II. DEBTOR IS NOT ENTITLED TO WARN ACT EXCEPTIONS

A. The "faltering company" exceptions pursuant to 29 U.S.C. § 2102(b)(6) and the "unforeseeable business circumstances" exception pursuant to 29 U.S.C. § 2102(b)(2)(B) do not apply.

As set forth above, WARN is designed to provide employees with sixty (60) days' advance notice of any plant closing in order to provide them and their respective communities adequate time to prepare for the ultimate loss of employment and to minimize the harmful financial and social impact of the termination

Under WARN, an employer may order a plant closing or mass layoff before the conclusion of sixty days without violating the Act's notice requirement if the closing or layoff is made pursuant to one of the Act's three limited exceptions. An employer is permitted to close a plant or lay off employees with less than sixty day's notice when (i) the business is faltering (29 U.S.C. § 2102(b)(i) (ii) there are unforeseeable business circumstances (29 U.S.C. § 102(b)(2)(A)) or (iii) there is a natural disaster (29 U.S.C. § 2102(b)(2)(B)).

The first exception referred to as the "faltering company" exception states that an employer may order the shutdown of a facility before the conclusion of the sixty-day period if:

> "As of the time that notice would have been required, the employer was actively seeking capital or business which, if obtained, would have enable the employer to

> avoid or postpone the shutdown and the employer reasonably and in good faith believed that giving the notice required would have precluded the employer from obtaining the needed capital or business." 29 U.S.C. § 2102(b)(1)

For the "faltering company" exception to apply, there must be (i) a realistic opportunity to obtain such financing or business, which (ii) if achieved would have avoided closure, and (iii) the employer reasonably and in good faith believed that such financing or business would be unavailable if notice were given. 20 C.F.R. § 639.9(a0(4). To satisfy condition (iii), the burden here is on United to show that its financial services with whom it was dealing would no longer transact business with its troubled company. *Id.*

The second, so-called "unforeseeable business circumstance" exception to the Act provides that "an employer may order a plant closing or mass layoff before the conclusion of the sixty-day period if the layoff or closing is caused by a business circumstance that was not reasonably foreaeeable as of the time that the notice would have or should have been given." 29 U.S.C. § 2102(b)(2)(A).

Under this exception, an employer is only acquired to give as much notice as is practical and, at tha time, give a brief statement explaining the basis for reducing the notification period 29 U.S.C. § 2102(b)(3). "The test for determining when business circumstances are not reasonably unforeseeable focuses on the employer's business judgment." 30 C.F.R. § 939.9(b)(2). A business circumstance is not reasonably foreseeable if it is caused by some "sudden, dramatic and unexplained action or condition outside of the employer's control." *Id. supra* at (b)(1).

To the extent that an employer fails to give the required notice, the Act provides that the employer will be liable to its employees and civil authorities. The employer will be liable

to each employee for back pay and benefits, including medical expenses, for the period that the employer failed to give the required notice. This period may not exceed sixty days. 29 U.S.C. §2104(a)(1)(2). The sixty days' back pay and lost benefits remedies for employees and the civil penalties are the exclusive remedies that may be sought against an employer violating the Act. 29 U.S.C. § 2104(b).

B. Application of WARN Act exceptions to the history of debtor prior to filing.

Both of these exceptions to the WARN Act mandate a detailed examination of the history of debtor prior to the filing of the bankruptcy. The sixty-day period prior to the bankruptcy would have commenced approximately December 19, 1996. As early as September 25, 1996, the minutes of the Board of Trustees ("Board") of the Hospital disclose that a committee had been formed to discuss possible affiliations of the institution with other medical facilities, The Committee report of the "affiliation Committee" is part of the Board minutes of September 25, 1996 and reads in part:

> "The Committee came to the conclusion that United does need a partner to survive in this environment and time is of the essence in coming to a conclusion as to who that partner will be." (Exh. D-3)

For the "unforeseeable business circumstance" exception of the Act to apply, this Court would have to conclude that debtor's financial collapse was the result of a sudden, dramatic and unexpected action or condition outside of the management's control. The record which ws established before the Court in connection with four days of testimony on February 27, 28, March 4 and 5, 1997 dealing with the sale of debtor's "good will" to St. Barnabas Hospital for approximately $13 million demonstrated to the Court a picture of the economic chaos which faced debtor prior to the bankruptcy. The four-day record in the St. Barnabas transaction was sup-

plemented with testimony taken on March 21, 1997 before this Court in connection with the WARN Act issue. On March 21, 1997, Mr. Thomas Barry, Vice President of Cain Brothers who had previously testified in connection with the St. Barnabas transaction resumed the stand. He reiterated that he had been retained by debtor's Board in early February and that he observed United in dire financial condition, One of the first actions that Mr. Barry did was to recommend that the Board retian a management company to attempt to organize debtor's books and records and to regain control of what was a chaotic financial situation. Mr. Barry expressly testified on March 21, 1997 that he was not retained to find long-term financing for debtor by way of possible stock or bond offerings nor was he retained for conventional mortgage financing. Mr. Barry testified that he was retained to put together a request for proposals on an emergency basis that would attempt to salvage in a quick transaction as much of debtor's assets as was possible. As noted previously, throughout the end of 1996 the task force committee of the Board has been focusing on a merger with another medical institution as the way out of United's financial problems. As noted, the Board had focused its efforts on a possible merger with St. Barnabas. However, by January 15, 1997, St. Barnabas had advised United that it was no longer interested in merger discussions. (Exh. C-3, Tab 3,—Board Minute).

Mr. Dandridge, Chief Executive Officer ("CEO") of United, took the stand on March 21, 1997 and testified that he joined United as CEO in January of 1993 and that when he came on board he knew that United was "a troubled institution." He further testified that by April of 1996, United started knowing substantial operating losses. When asked by the Court as to when United had trouble maintaining supplies such as blood and other such necessities, Mr. Dandridge testified that supply problems were a chronic situation going back to March of 1996. He further testified that by January 1997 United commenced diverting payments of certain withholding

and other tax obligations and using the funds for general operating expenses. Asked as to the nature of the health insurance coverage maintained by United for the benefit of its employees, Mr. Dandridge testified that in February of 1997 when he took his daughter to have her treated for medical services, he was advised that the Blue Cross/Blue Shield policy for the benefit of the employees maintained by United had been canceled for the non-payment of the October-November premium.

On October 21, 1996, United had entered into a receivables purchases and transfer agreement with DAIWA Securities America, Inc. ("DAIWA"). Mr. Dandridge testified that he reported to the Board at its December 18, 1996 meeting (Exh. C-3, Tab 1) that he, Mr. Dandridge, had had a dinner meeting with representatives of DAIWA and that they were very upset with the quality of financial information being provided to DAIWA by United. The deteriorating financial condition of United throughout January 1997 results in the Department of Human Services, Division of Medical Assistance and Health Services of the State of New Jersey taking steps to advance future payments to United (Exh. C-3, Tab 6). By January 28, 1997, Mr. Dandridge testified the Board minutes reflect that bankruptcy counsel have been invited by United to sit in on Board meetings. (Exh. C-3, Tab 5).

The Court notes, based on the record before it throughout the St. Barnabas hearing as well as the two days of testimony taken on the WARN Act aspect of this case, that the Board of United labored long and hard in its efforts to keep United's doors open. While this Court had previously questioned the business judgment of the Board in the pre-bankruptcy offer it accepted, it is nonetheless apparent from the sum total of the record that the Board at all times tried to do what it felt was in the best interests of the patients, the employees, and United in general. There came a point in time by the Board meeting of February 16, 1997 that for all intents and purposes United

ended as an operating hospital. Within hours of said Board meeting, United is requesting the Commissioner of Health to revoke its certificate of need to operate as a hospital and is moving forward with a Chapter 11 bankruptcy petition and in the context of that bankruptcy petition is moving to dispose of much of its assets.

This Court must now evaluate whether that history entitles debtor-in-possession as is asserted by the Unsecured Creditors' Committee to exception from the provisions of the WARN Act. This Court concludes from the aforesaid history that the unforeseeable business circumstances exception does not apply to United. There were months of warning signals to the Board that placed them on notice that United was in financial extremis and that the facts leading to United filing bankruptcy on February 19, 1997 were far from an unforeseeable business circumstance so as to justify an exception to the WARN Act.

The second relevant exception to the WARN Act is the so-called "faltering business" exception. This portion of the statute would allow United to avoid WARN Act exposure if at the time the WARN Act's notices should have been given debtor was seeking capital with the intention of continuing to operate and if the management felt that the giving of the notice would have hurt or precluded the efforts of the estate to recapitalize. Debtor's problems were deep, long-term and critical in nature. This is not a typical Chapter 11 situation where a company or business simply needs a new bank or benefactor and honestly believes a refinancing agreement or the bringing on board of a new lender within a short time frame will turn a business around. Quite the contrary, United for many months was heading towards being absorbed by another hospital or closure. While the Board and particularly, Mr. Dandridge, held out the hope that one of the possible scenarios would allow United to continue to exist in some format, nonetheless this hope or expectancy cannot defeat the

employees of their statutorily imposed right to be warned sixty days before their employment is terminated. Debtor's continuing problems in obtaining essential supplies which date back to mid-1996, debtor's failure to pay the October-November 1996 Blue Cross/Blue Shield health insurance premiums which ultimately results in a cancellation of employees' benefits, coupled with the diversion of fiduciary tax obligations in January of 1997, make it imminently clear that no matter what the good intentions of certain members of the Board may have been, United was withering on the vine and the employees were entitled to their sixty-day WARN Act notice. It is, in fact, in recognition of this point that the Board ultimately, upon the filing of the bankruptcy on February 19, 1997, does issue a WARN Act notice and does state to the employees that in recognition of the application of the statute and the entitlement to the benefit, it is the intention of United to pay the employees wages for a sixty-day period following the filing of the Chapter 11 petition.

In sum, the Court concludes that there was a closing of a shutdown of the debtor so as to trigger the application of the WARN Act statute. The debtor is not entitled to either the "faltering business" or "unforeseeable business circumstance" exceptions and the employees for their part are entitled to their full EARN Act protection. The immediate issue before the Court is can debtor continue with its policy of paying the furloughed employees their paychecks so as to satisfy debtor's WARN Act liabilities. The next paycheck due to the employees is March 27, 1997 and would be for a two-week pay period ending March 22, 1997. As noted above, throughout the pay period at issue, relevant employees of the debtor have been on furlough and have not been reporting to duty at United.

III. ADMINISTRATIVE STATUS IS GRANTED TO WARN ACT CLAIMS.

The question of whether or not the debtor may continue with its policy of paying the furloughed employees their paychecks so as to satisfy the debtor's WARN Act liabilities, must be answered in the context of the priority of distribution of claims as set forth under section 507 of the Bankruptcy Code.

As discussed by Judge Stripp in the *Hanlin* case, first priority distribution rights are accorded to "the actual, necessary costs and expenses of preserving the estate, including wages, salaries or commissions for services rendered after the commencement of the case. . ." 176 B.R. at 329 (citing 11 U.S.C. § 503(b)(1)(A) and § 507(a)(1)). As has been recognized, such expenses arise from transactions with a debtor-in-possession, where the consideration, supporting the transaction is beneficial to operation of the debtor's business. 176 B.R. at 332 (citing *In re Jartran, Inc.*, 732 F.2d 584, 587 (7th Cir. 1984)). The burden of proving that the WARN Act claims are entitled to administrative priority is on the party asserting such status, in this case; the debtor and employees. *Id.* at 333.

In examining the issue of whether "back pay" under WARN is entitled to priority as an administrative claim for "wages" under the Bankruptcy Code, Judge Stripp, in *Hanlin*, reasined that while the term "wages" is not defined under § 503, its meaning therein is the same as under § 507, which section defines "wages" to include "vacation, severance, and sick leave pay." *Id.* at 11 U.S.C. § 503(a)(3). Judge Stripp then reviewed the holdings of several of the only courts to have addressed the issue and concluded that "given the compensatory nature of back pay, it must be in the nature of wages under the Code." *Id.* (citing *In re Riker Industries, Inc.*, 151 B.R. 823 (Bankr. N.D. Ohio 1993); *In re Cargo*, 138 B.R. 923 (Bankr. N.D. Iowa 1992), and *United Steelworkers.*

of America, AFL-CIO-CLC v. North Star Steel Co., 5 F.3d 39 42 (3d Cir. 1993), cert. Denied, 510 U.S. 1114, 114 S.Ct. 1060, 127 L.Ed.2d 380 (1994). This Court's review of *Cargo, Riker* and *North Star* finds in accord with the review of those cases in *Hanlin* insofar as both *Riker* and *Cargo* concludes that given the compensatory nature as statutory severance pay, back pay under WARN constitutes wages for the purposes of the Bankruptcy Code Quoting *Cargo*, the *Hanlin* court stated that the cases are In agreement that:

> "The "back pay" liability of the employer is comparable to privately negotiated severance pay. It is severance pay in lieu of notice, imposed by statute. It is a "quasi-contractual" obligation. As a statutorily imposed form of severance pay, it is "wages" within the meaning of § 507(a)(3) of the Code." 176 B.R. at 333 (citing *Cargo*, 138 B.R. at 927).

Having determined that WARN Act "back pay" constitutes wages under the Code and is therefore subject to the administrative priority provisions of § 503 and § 507, the court must finally determine whether the WARN Act claims in this particular case constitute first priority administrative claims under § 597(a)(1) and § 503(b)(1)(A).

In recognizing that not all wage claims are entitled to priority as administrative claims under the Bankruptcy Code, this Court notes the "three-tier" system of priorities discussed in *Hanlin*. First, the actual necessary costs and expenses of preserving the estate, including wages for services rendered after the commencement of the case are entitled to first priority as administrative claims, 11 U.S.C. § 507(a)(1), 503(b)(1)(A). Wages earned within ninety (90) days before the date of filing of the petition or the date of the cessation of business, whichever comes first, are entitled to third priority, but only to the extent of $4,000 per person, 11 U.S.C. § 507(a)(3). All other wage claims are entitled to the same priority as other general unsecured claims. 176 B.R. at 334.

As applied to the facts of this case, the Court finds that debtor had 1,300 of its employees report to work for 16 days post-petition entitles the employees' WARN Act claim to treatment as a Chapter 11 first priority administrative expense in accord with *Hanlin.* In so holding, the Court specifically finds that the debtor used these employees to perform valuable services to the estate. In so doing, the WARN Act obligation of United transferred to the DIP. The management of the debtor recognized this essential contribution of the employees and the fact that it benefited the estate during the 16-day wind-down by stating in the March 6, 1997 Furlough Notice:

> "Since the transfer of the patients from United, you have accomplished much in the way of the inventory, clean-up, and securing of the physical plant and equipment. Your efforts are greatly appreciated, especially during this personally trying time for us all." (Exh. C-1).

In sum, the work the 1,300 employees did in the 16-day period highlighted in Exh. C-1, wherein the DIP thanks the employees for inventory services and the securing and clean-up of its equipment and plant, clearly benefited the Chapter 11 estate. Thus, the contributions of the employees were within the meaning of 11 U.S.C. § 503(b)(1)(A) as wages for services rendered which constitute the "actual, necessary costs and expenses" of preserving the United estate.

The Committee's motion seeking to terminate all employees immediately is denied. The employees are awarded a WARN Act administrative claim in accordance with the terms of this Opinion. However, the sole remaining cash asset within the estate at this time is approximately $2 million which represents the balance of the deposit from the sale of debtor's "good will" to St. Barnabas. DAIWA, a secured creditor, has asserted a lien on said funds. Said lien has been contested by debtor and the Committee in separate proceedings before this Court. Payment of the WARN Act claim

cannot be paid at this time out of debtor's cash assets pending a resolution of this lien. Therefore, debtor is not authorized to issue paychecks to its employees in connection with the WARN Act claim pending further order of this Court. The salary of the approximately 100 employees currently performing services may be paid in the normal course.

DATED: March 26, 1997

/S/ William F. Tuohey
WILLIAM F. TUOHEY
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

Case No. 97-21785
Chapter 11
Hearings: March 7, 21, 1997

In Re: UNITED HEALTHCARE SYSTEM, INC.
Debtor-in-Possession

ORDER

This matter having come before the Court on an Order Shortening Time by the Unsecured Creditors' Committee seeking to have the Court direct debtor to immediately terminate all employees except those necessary to protect debtor's estate; and

The Court having considered the arguments of counsel on March 7, and 21, 1997, as well as the submission of the parties; and

The Court having rendered a written Opinion this date, the terms of which are incorporated herein by reference,

IT IS on this 26th day of March, 1997

ORDERED that:

1. United is an employer for the purpose of the Worker's Adjustment and Retraining Notification Act ("WARN") 29 U.S.C. § 2101;

2. The exceptions to WARN pursuant to 29 U.S.C. § 2102(b) do not apply;

3. The "back pay" due under WARN constitutes an administrative first priority expanse of United's estate pursuant to § 503 and § 507 of the Bankruptcy Code,

4. United is free to continue paying the 100 actual working employees, and

5. The furloughed employees as noted are granted an administrative priority WARN Act claim, the payment of which will abide further Order of the Court.

/s/ William F. Touhey
WILLIAM F. TUOHEY
U.S. Bankruptcy Judge